A COMPARATIVE STUDY OF THE IMPACT OF INFLATION AND DEFLATION IN THE INDIAN ECONOMY

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ABSTRACT

This study focuses mainly on the impact of inflation and deflation in India. Inflation is the rate of increases in prices over a given period of time, e.g., one year. Inflation is typically a wider measure, such as the overall increase in prices or the increases in the cost of living in a country. But it can also be more narrowly calculated—for specific goods, such as food, or for services, such as a haircut, for example. Whatever the context, inflation represents how much more expensive the relevant set of goods or services has become over a certain period, most commonly a year. Deflation is generally a decline in the prices of goods and services. Deflation will take place naturally if and when the money supply of an economy is limited. Deflation in an economy indicates deteriorating conditions or situations.

As a result, the rate of inflation is increasing. Inflation is a sustained rise in overall price levels. Moderate inflation is associated with economic growth and the development of a country, while high inflation can signal an overheated economy. Deflation is normally linked with significant unemployment and low productivity levels of goods and services. The term "deflation" is often mistaken with "disinflation." While deflation refers to a decrease in the prices of goods and services in an economy, disinflation is when inflation increases at a slower rate.

KEYWORDS: Inflation, Deflation, Economy, Unemployment, Productivity, Goods and Services.

INTRODUCTION

Inflation refers to a rapid increase in the general price level. Its effects cause a decline in purchasing power and the value of money. In other words, the impact of inflation is that it reduces the purchasing power of households due to an increase in prices. The impact of inflation is felt across different sectors of the economy, which are favourable to some and unfavourable to others. It occurs as a result of a mismatch between the supply and demand for money, changes in production and distribution costs, or an increase in product taxes. Inflation is measured by the Consumer Price Index in India.

The term deflation refers to a general fall in the prices of commodities. Although it may appear to be beneficial, it is not good for the economy. Deflation is commonly linked to economic slowdowns, low or poor productivity, and job losses. Inflation lowers the value of money or lowers the purchasing power of money, while deflation raises it. This encourages consumers to save money now in order to buy products later, when they are cheaper. And as a result of this economic behaviour, growth slows down even more. Deflation reduces production of goods and services due to a reduction in demand from consumers. A reduction in the production of goods and services leads to reduced investments, a reduction in the salaries of employees, and also increases unemployment. All these lead to a massive reduction in the economic growth of the nation.

OBJECTIVE OF STUDY

The study is based on the following objectives:

- To study the types and causes of inflation and deflation.
- To comparative study of the impact of inflation and deflation.
- To study the various control techniques of inflation and deflation.

Review of Literature

- Research paper 'Impacts & Aspects of Inflation: A Study on Indian Economy' analysis by Rahul Soni and Vikas Kumar Chouhan. According to this study, inflation has a direct effect on how much money households have to spend or save, which in turn hurts both spending and saving or investing.
- Inflation and Economic Growth in India –An Empirical Analysis by Prasanna V Salian1, Gopakumar. K2. According to this study, the inflation-growth nexus in India has been systematically analyzed. The important conclusion is that any increase in inflation from the previous period negatively affects growth.

Research Methodology

- This research paper is conceptual and descriptive. It is social research and research based on secondary data for the proper finding and analysis. Secondary data is collected from news papers, periodicals, books, journals, and websites.

Types of Inflation-

Following are the four main types of inflation:

- **Creeping inflation** is a situation where inflation in an economy increases gradually. It is one of the mildest types of inflation and is required to maintain a stable economy.
- **Walking inflation,** also known as trotting inflation, is a situation when the prices rise up to 10%. Walking inflation gives a cautionary signal for the occurrence of galloping inflation.
- **Galloping inflation** refers to the state of the economy when the prices of goods and services increase at a rapid rate of 10% or more.
- **Hyperinflation: Hyperinflation** is experienced by an economy when prices skyrocket more than 50% in a month. The primary cause of such situations is the rise of the money supply in an economy that is not supported by GDP growth.

Causes of Inflation

Factors increasing demand:

- Increase in public expenditure; increase in exports
- reduction in taxation
- Black money

Factors decreasing supply:

- Shortage of factors of production: raw material; man
- Hoarding by traders and consumers; natural causes (floods, earthquakes);
- Increase in the cost of production.

Impact of inflation

The effect of inflation on the economy can be stated as follows:

- The effect of inflation is not distributed evenly in the economy. There are chances for hidden costs for different goods and services in the economy.
- Sudden inflation rates are harmful to an overall economy. They lead to market instability and thereby make it difficult for companies or businesses to plan a budget for the long term.

Positive Impact

Stimulates Economic Growth:- Inflation kept at a modest level fosters economic growth by increasing firms' profit margins in the near run, encouraging them to boost output and supply. No Deficiency in Demand: It signifies that there is no demand shortage in the economy, which raises profitability expectations and encourages businesses to invest and expand production capacity.

- Increased Profits for Producers
- Increased employment and earnings
- Shareholders income increases.
- Borrowers' Advantages
- Governments' tax revenue improves

Negative Impact

Deteriorates Standard of Living: People's quality of life is lowered when their discretionary income is reduced. Creates shortages of goods, Inflationary pressures may lead to shortages of products if people begin stockpiling in anticipation of future price increases.

- Real-Income falls for groups with fixed income.
- Income Distribution Inequality Rises
- Lenders will sustain losses.
- The rupee may depreciate.

Types and Causes of Deflation

Deflation can be particularly harmful to borrowers, who may be forced to repay their debts in money that is worth more than the money they borrowed, as well as to financial market participants who invest in or speculate on the prospect of rising prices.

Types of deflation: There is bad deflation, which is when demand for a good aggregate or service falls faster than aggregate supply. Then there is good deflation; deflation is considered good when aggregate supply grows faster than aggregate demand.

There are five main causes of deflation.

- Decrease in aggregate demand or low confidence
- Increased productivity
- Technological advances
- decrease in the supply of currency
- Monetary policy

Impact of deflation

Deflation may have the following impacts:

Reduction in Business Revenues

In an economy with deflation, businesses have to cut the prices of their goods and services by a lot to stay in business. As reductions in prices take place, revenues begin to drop.

Lowered Wages and Layoffs

When revenues begin to drop, businesses need to find means to reduce their expenses to meet objectives. One way is by reducing wages and cutting jobs. This adversely affects the economy as consumers will now have less to spend.

- **Low Growth:** High unemployment and low levels of making goods and services are usually signs of deflation.
- **Reduces consumer spending:** When prices are falling, people are more likely to postpone purchases because they will be cheaper later.
- **Increase the real value of debt:** Deflation increases the real value of money and debt.

There is also one positive effect of deflation:

- Greater Export Competitiveness: If most other economies are suffering from inflation, a positive effect of deflation could be increased export competitiveness. Exports will be profitable as the cost of products and services falls.

Comparative study of the impact of inflation and deflation-

BASE OF COMPRISION	INFLATION	DEFLATION
Impact on demand	Demand for products and services increase in inflation.	Demand for products and services decrease in deflation.
Impact on National Income	No impact on national income	National income declines as a result of deflation
Is it beneficial?	Moderate levels of inflation is considered good for the economy.	Calculated based on only the amount that is availed
Consequences seen	Distribution of income is not equal as a result of inflation.	There is a rise in level of unemployment in the nation as a result of deflation
Impact on Purchasing Power of Money	Decreases the purchasing power of money.	Increases the purchasing power of money.

Control of Inflation

- Inflation can be controlled by a monetary policy, which is one common method of managing inflation. A policy aims to reduce the supply of money within an economy by lowering the prices of bonds and raising interest rates.
- The RBI can purchase or sell government securities from or to the public. To control inflation, the RBI sells securities in the money market, which sucks out excess liquidity from the market. As the amount of liquid cash decreases, demand goes down. This part of monetary policy is called the open market operation.

Monetary Measures-

- Credit Control
- De-monetization of currency
- issue of new currency

Fiscal Measures-

- Cuts in expenditure
- Increase in taxes
- Increase in savings
- Surplus budget
- Public debt

Other Measures-

- Raise production
- Rational wage policy
- Price control
- Rationing

Control of Deflation

We know what causes deflation, but how can it be controlled? Deflation is more difficult to control than inflation due to some of the limitations that monetary authorities run into. Some ways to control deflation are:

- Changes to monetary policy
- decrease interest rates
- Unconventional monetary policy

Fiscal policy is when the government changes its spending habits and tax rates to influence the economy. When there is a risk of deflation or it is already happening, the government can lower taxes to keep more money in the citizen's pockets. They can also increase their spending by issuing stimulus payments or offering incentive programmes to encourage people and businesses to start spending again and move the economy forward.

Conclusion-

Inflation may be due to the supply of money increasing its demand. Other factors, like a decrease in production or high expenditures on consumable items, etc., can cause inflation if not matched with their demand. There are different types of inflation: hyperinflation, creeping inflation, cost-push inflation, demand-pull inflation, stagflation, etc. It is the steady rise of prices for goods and services over a period of time and has more effects. As inflation erodes the value of money, it encourages consumers to spend and stock up on items that are slower to lose value. It decreases the cost of debt and lessens unemployment. Deflation has been around for as long as inflation has, but it does not occur as often. Inflation is an increase in the general price level, whereas deflation is a decrease in the general price level. If we think of inflation and deflation in terms of percentages, inflation would be a positive percentage while deflation would be a negative percentage.

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